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SUBJECT: JORDAN GEARS UP FOR ARAB FREE TRADE

SENSITIVE BUT UNCLASSIFIED; PLEASE HANDLE ACCORDINGLY.

1. (SBU) SUMMARY: WITH TRADE WITH OTHER ARAB COUNTRIES MAKING UP A SIZEABLE PORTION OF ITS OVERALL TRADE, JORDAN WAS ONE OF THE FIRST COUNTRIES TO EMBRACE THE ARAB FREE TRADE AGREEMENT (AFTA), WHICH AIMS AT CREATING AN ARAB FREE TRADE AREA BY 2005. INDEED, SINCE ENTERING INTO FORCE, JORDAN HAS SEEN THE AFTA CREATE NEW REGIONAL OUTLETS FOR ITS INDUSTRY, BLUNTING THE IMPACT ON JORDAN'S INDUSTRY OF WTO MEMBERSHIP AND THE U.S.-JORDAN FTA AND ARGUABLY MAKING THE COUNTRY MORE ATTRACTIVE TO FOREIGN INVESTORS. ALTHOUGH THE COVERAGE OF AFTA IS EXPANDING AS LISTS OF EXEMPTED GOODS DIMINISH AND WITH DISCUSSIONS SLATED ON EXTENDING IT TO TRADE IN SERVICES, DOUBTS PERSIST AS TO WHETHER THE AFTA WILL BE EFFECTIVE IN RAISING INTER-ARAB TRADE OVERALL, THUS HAVING A POSITIVE, TRADE-CREATING IMPACT ON REGIONAL ECONOMIES. HOW THE AFTA TREATS FREE TRADE ZONES, LIKE JORDAN'S AQABA SPECIAL ECONOMIC ZONE OR DUBAI'S JEBEL ALI, IS A MAJOR QUESTION MARK. END SUMMARY.

JORDAN'S TRADE WITH ARAB COUNTRIES

2. (U) TRADE WITH ARAB COUNTRIES ACCOUNTED FOR 28 PERCENT OF JORDAN'S TOTAL TRADE VOLUME IN 2001 AND MUCH OF THE PAST DECADE. CONSEQUENTLY, ARAB COUNTRIES COMBINED REPRESENT JORDAN'S LARGEST TRADING PARTNER, FOLLOWED BY THE EUROPEAN UNION (WHICH ON AVERAGE ACCOUNTS FOR 24 PERCENT OF JORDAN'S TRADE) AND THE UNITED STATES (WHICH ACCOUNTED FOR SOME 9.5 PERCENT OF JORDAN'S TRADE IN 2001). THIS MAKES JORDAN'S RATIO OF INTER-ARAB TRADE ONE OF THE HIGHEST, IF NOT THE HIGHEST, AMONG ARAB COUNTRIES, COMPARED WITH AN AVERAGE OF 8.7 PERCENT FOR ALL ARAB COUNTRIES COMBINED. THE ARAB COUNTRIES WITH WHICH JORDAN TRADES THE MOST ARE IRAQ, SAUDI ARABIA, THE UAE, SYRIA, LEBANON AND EGYPT. IRAQ AND SAUDI ARABIA CONSTITUTE JORDAN'S FIRST AND FOURTH BIGGEST TRADING PARTNERS RESPECTIVELY.

3. (U) A CLOSER LOOK AT JORDAN'S TRADE DATA WITH ARAB COUNTRIES SHOWS THAT CRUDE OIL AND PETROLEUM PRODUCTS, WHICH ARE IMPORTED EXCLUSIVELY FROM IRAQ, MAKE UP THE BIGGEST PORTION OF JORDAN'S ARAB TRADE (SOME 35 PERCENT) AND AROUND 10 PERCENT OF JORDAN'S OVERALL TRADE VOLUME. JORDAN IMPORTED JD 821.2 MILLION (USD 1,149.7 MILLION) OF PRODUCTS FROM ARAB COUNTRIES IN 2001, REPRESENTING 24 PERCENT OF TOTAL IMPORTS. CRUDE OIL AND PETROLEUM IMPORTS ACCOUNTED FOR 58 PERCENT OF THE TOTAL, FOLLOWED BY FOODSTUFFS, PLASTIC PRODUCTS, ALUMINUM, IRON AND STEEL. JORDAN EXPORTED JD 542.5 MILLION (USD 764.9 MILLION) OF PRODUCTS TO ARAB COUNTRIES IN 2001 REPRESENTING SOME 40 PERCENT OF TOTAL EXPORTS. PHARMACEUTICAL EXPORTS CAME FIRST WITH 21 PERCENT OF THE TOTAL, FOLLOWED BY VEGETABLES, PAPER AND CARDBOARD, PLASTIC BAGS, FODDER, AND CEMENT.

4. (U) JORDAN HAS LONG HAD A TRADE DEFICIT WITH ARAB COUNTRIES, AVERAGING AROUND 50 PERCENT OF EXPORTS OVER THE PAST THREE YEARS. THIS IS NOT SURPRISING, SINCE JORDAN, WITH ITS LIMITED RESOURCE BASE, HAS HISTORICALLY SUFFERED FROM AN OVERALL TRADE DEFICIT. OIL IMPORTS COULD ACCOUNT FOR THE WHOLE AMOUNT OF THE DEFICIT WITH ARAB COUNTRIES, AND CONSEQUENTLY, THE SIZE OF THIS DEFICIT FLUCTUATES ALMOST IN TANDEM WITH MOVEMENTS IN THE PRICE OF OIL.

THE ARAB FREE TRADE AGREEMENT (AFTA)

5. (U) ARAB COUNTRIES' EFFORTS AT REGIONAL COOPERATION LONG FAILED TO PRODUCE TANGIBLE RESULTS, ALTHOUGH TALK OF A COMMON MARKET STARTED IN THE 1950'S. HOWEVER, IN MARCH 1998, ELEVEN ARAB COUNTRIES ESTABLISHED THE ARAB FREE TRADE AGREEMENT (AFTA) ALSO KNOWN AS THE GREATER ARAB FREE TRADE AREA (GAFTA) OR

PAN-ARAB FREE TRADE AREA (PAFTA). THEIR NUMBER LATER INCREASED TO FOURTEEN COUNTRIES INCLUDING: LEBANON, JORDAN, SYRIA, EGYPT, MOROCCO, TUNISIA, IRAQ, LIBYA AND SIX MEMBERS OF THE GULF COOPERATION COUNCIL (GCC) NAMELY BAHRAIN, KUWAIT, OMAN, QATAR, SAUDI ARABIA AND THE UNITED ARAB EMIRATES (UAE).

16. (SBU) NOTE THAT JORDAN IS PURSUING ITS PARTICIPATION IN AFTA ON A SEPARATE TRACK FROM BILATERAL AND SUB-REGIONAL EFFORTS TO LIBERALIZE ITS TRADE WITH ARAB COUNTRIES. THESE EFFORTS INCLUDE THE "AGADIR PROCESS" OF COUNTRIES WITH EU ASSOCIATION AGREEMENTS, TRADE, TRANSPORT AND CUSTOMS AGREEMENTS WITH SYRIA, KUWAIT, EGYPT AND OTHERS. THESE AGREEMENTS ARE GENERALLY LESS AMBITIOUS, IN TIMING AND/OR IN COVERAGE, THAN THE AFTA, AND ARE SOMETIMES DRIVEN IN LARGE PART BY POLITICAL CONSIDERATIONS.

17. (U) UNDER THE AFTA, MEMBERS ARE REQUIRED TO AFFORD GOODS PRODUCED IN OTHER MEMBER STATES NATIONAL TREATMENT, RESULTING IN REDUCED TARIFFS, FEES AND TAXES ACCORDING TO A GRADUAL LIBERALIZATION SCHEDULE STARTING JANUARY 1998. INITIALLY, THE TARIFF REDUCTION WAS SUPPOSED TO BE 10 PERCENT ANNUALLY, THEREBY ESTABLISHING A FREE TRADE AREA BY 2007. MEMBER COUNTRIES AGREED AT THE BEIRUT ARAB SUMMIT IN MARCH 2002 TO ADVANCE THE DATE OF THE ARRIVAL OF THE FREE TRADE AREA TO 2005 BY REDUCING EXISTING TARIFFS BY 50 PERCENT IN 2002, TEN PERCENT IN 2003 AND 20 PERCENT IN BOTH 2004 AND 2005. IN ADDITION, ARAB LEADERS AGREED IN PRINCIPLE TO INCLUDE THE LIBERALIZATION OF TRADE IN SERVICES IN FUTURE DISCUSSIONS. ACCORDING TO SAMER TAWIL, SECRETARY GENERAL OF JORDAN'S MINISTRY OF INDUSTRY AND TRADE, THIS YEAR'S TARIFF REDUCTION HAS ALREADY BEEN IMPLEMENTED FOR ALL MEMBER STATES EXCEPT FOR MOROCCO, WHICH IMPLEMENTED A 30 PERCENT TARIFF REDUCTION ONLY. THE REMAINING REDUCTIONS WILL TAKE PLACE ON JANUARY FIRST OF EACH YEAR.

18. (U) WHILE THE MOST OBVIOUS SHORTCOMING OF THE AFTA IS THAT IT DOES NOT APPLY TO SERVICES, ITS COVERAGE OF GOODS ALSO LEAVES MUCH TO BE DESIRED. WHEN THE AFTA WAS SIGNED, MEMBER COUNTRIES ADOPTED LONG, WIDE-RANGING LISTS OF EXEMPTED PRODUCTS (NEGATIVE LISTS), PURPORTEDLY TO ALLOW NATIONAL INDUSTRIES TIME TO ADJUST TO COMPETITION. UNDER THE AGREEMENT, THESE LISTS ARE SUPPOSED TO BE TEMPORARY IN NATURE AND SHOULD NOT ACCOUNT FOR MORE THAN 15 PERCENT OF TOTAL INTER-ARAB TRADE VOLUME. INDEED, LOCAL EXPERTS SAY THAT NEGATIVE LISTS AMOUNT TO LESS THAN 6 PERCENT OF INTER-ARAB TRADE. THESE EXEMPTIONS ARE SLATED TO BE DROPPED BY SEPTEMBER 16, 2002, WITH MEMBER COUNTRIES ARE NOT ALLOWED TO INTRODUCE NEW ONES WITHOUT A DETAILED EXPLANATION. HOWEVER, DOUBTS LINGER IN BOTH THE PRIVATE SECTOR AND THE JORDANIAN GOVERNMENT AS TO WHETHER ALL AFTA MEMBERS WILL ABIDE BY THIS STIPULATION. IN PARTICULAR, MORE THAN ONE CONTACT EXPRESSED DOUBT THAT EGYPT WILL REALLY ELIMINATE ITS LIST OF EXEMPTED TEXTILE GOODS OR THAT MOROCCO WILL DO SO FOR ITS AGRICULTURAL PRODUCTS.

19. (U) MEMBER COUNTRIES ALSO STILL NEED TO FINALIZE THE ISSUE OF COUNTRY OF ORIGIN RULES AND PROCEDURES. GENERALLY SPEAKING, TO QUALIFY FOR PREFERENTIAL TREATMENT UNDER AFTA, GOODS HAVE TO SHOW A 40 PERCENT VALUE-ADDED IN THE COUNTRY OF ORIGIN AND A SUBSTANTIAL TRANSFORMATION. AN ARAB LEAGUE ECONOMIC COUNCIL (ALEC) MEETING NEXT SEPTEMBER WILL DISCUSS THE ISSUE MORE THOROUGHLY, INCLUDING A PROPOSAL TO TIGHTEN RULES OF ORIGIN ALONG THE LINES OF EU STANDARDS, WHICH ARE FAR STRICTER: 50 PERCENT LOCAL CONTENT WITH ONLY CERTAIN PRODUCTION PROCESSES QUALIFYING TOWARDS THAT TOTAL. FINALLY, PROBLEMS OF STANDARDS AND TECHNICAL BARRIERS TO TRADE (TBT'S) PERSIST AND A WORKING GROUP HAS BEEN ESTABLISHED UNDER THE ALEC TO VISIT MEMBER STATES AND STUDY THEIR CUSTOMS PROCEDURES IN ORDER TO MAKE RECOMMENDATIONS FOR ALEC ON HOW TO REDUCE THEM.

PROJECTED IMPACT

10. (SBU) ACCORDING TO TAWIL, AFTA WILL INCREASE OPPORTUNITIES FOR JORDANIAN EXPORTERS TO COMPETE WITH LOWER COST ASIAN -- PARTICULARLY CHINESE -- COMPETITORS IN OTHER ARAB MARKETS. HE ESPECIALLY NOTED SYRIA AND SAUDI ARABIA AS PROMISING. LOWER DUTIES, TARIFFS AND TAXES, AND -- ESPECIALLY -- LOWER TRANSPORTATION COSTS, HE SAID, WOULD COMPENSATE FOR RELATIVELY HIGHER LABOR AND PRODUCTION COSTS IN JORDAN COMPARED TO EAST ASIA. BY OPENING ARAB MARKETS, THE JORDANIANS ALSO HOPE AFTA WILL SOFTEN THE BLOW OF JORDAN'S WTO MEMBERSHIP AND THE U.S.-JORDAN FTA ON SMALLER, LESS COMPETITIVE JORDANIAN PRODUCERS WHO CATERED TO THE LOCAL MARKET AND SEEN THEIR MARKET

SHARE DIMINISH. TAWIL ALSO ARGUES THAT THE COMBINATION OF THE AFTA WITH THE U.S. FTA AND EU ASSOCIATION AGREEMENT WILL MAKE JORDAN MORE ATTRACTIVE TO FOREIGN INVESTORS AS A REGIONAL TRADING HUB.

11. (U) ALREADY SOME BENEFITS ARE MEASURABLE: LAST YEAR, JORDAN'S EXPORTS TO ARAB COUNTRIES GREW BY 23 PERCENT. THE FIRST SIX MONTHS OF THIS YEAR HAVE SEEN A 17 OR 18 PERCENT INCREASE. ACCORDING TO TAWIL, EXPORTS TO SYRIA ARE UP BY MORE THAN 100 PERCENT LED BY AGRICULTURAL EXPORTS, WHICH ARE UP BY 250 PERCENT. IN ADDITION, EXPORTS TO ALGERIA ARE UP BY 180 PERCENT, WHILE EXPORTS TO IRAQ ARE UP BY 10 PERCENT SO FAR THIS YEAR.

12. (SBU) THE BUSINESS COMMUNITY, HOWEVER, IS MORE SKEPTICAL. REPORTS OF CUMBERSOME AND ARBITRARY CUSTOMS PROCEDURES COUPLED WITH COMPLAINTS ABOUT IGNORANT AND INEFFICIENT CUSTOMS OFFICIALS ABOUND FROM JORDANIAN EXPORTERS. THE GAP BETWEEN POLICY AND IMPLEMENTATION CAN BE VERY WIDE, ESPECIALLY IN COUNTRIES LIKE IRAQ AND SYRIA, WHERE THE TECHNICAL EXPERTISE AND PAY OF CUSTOMS OFFICIALS IS VERY LOW. SOME FOOD AND PHARMACEUTICALS PRODUCERS REPORTED TO US AN ENDLESS SAGA OF COSTLY DELAYS AND EXPENSIVE BRIBES WHEN TRYING TO GET THEIR PRODUCTS THROUGH UNDER THE LATEST TARIFF REDUCTIONS TO SYRIA. IN ADDITION, THE PLETHORA OF TECHNICAL BARRIERS TO TRADE AND THE FICKLE NATURE OF INTER-ARAB RELATIONSHIPS -- AS MANIFESTED IN A RECENT KUWAIT-JORDAN TARIFF WAR OVER TRUCK TRANSPORT FEES -- RENDERS DOING BUSINESS IN THE ARAB REGION AN UNPREDICTABLE GAME.

FREE TRADE ZONES EXCLUDED?

13. (SBU) A CONCERN OF DIRECT BEARING ON U.S. COMPANIES IS HOW THE AFTA TREATS PRODUCTS OF DOMESTIC TAX-FREE OR "FREE TRADE" ZONES. ACCORDING TO THE JORDANIAN TRADE MINISTRY, AFTA MEMBERS SIGNED AN AGREEMENT THIS SPRING THAT EXCLUDED EXPORTS OF SUCH ZONES FROM THE BENEFITS OF AFTA PENDING FURTHER STUDY BY MEMBERS. IN MANY CASES, THIS HAS ACTUALLY RESULTED IN AN INCREASE IN TARIFFS ON EXPORTS FROM THESE ZONES TO AFTA MEMBERS. FOR EXAMPLE, ONE U.S. COMPANY WITH A REGIONAL DISTRIBUTION CENTER IN JEBEL ALI HAS COMPLAINED THAT IT NOW FACES NEW JORDANIAN TARIFFS OF 30% ON PROCESSED FOOD PRODUCTS BROUGHT IN FROM DUBAI, FIVE TIMES THE PREVIOUS RATE. IF THIS STAYS, THIS WOULD OBVIOUSLY BE A MAJOR GAP IN THE AGREEMENT THAT WORKS AGAINST GREATER REGIONAL AND GLOBAL INTEGRATION FOR THE ARAB WORLD.

COMMENT

14. (SBU) IN A WORLD OF REGIONAL TRADING BLOCS AND TRADE AGREEMENTS, INTER-ARAB TRADE REMAINS VERY LOW AND FRAGMENTED. AFTER TAKING OUT OIL AND MINERALS, INTER-ARAB TRADE IS ONLY 16 PERCENT OF TOTAL ARAB TRADE AND IS LARGELY CONCENTRATED ON TRADE IN AGRICULTURAL PRODUCE. THE ARAB FREE TRADE AGREEMENT (AFTA) INITIATIVE IS AIMED AT ADDRESSING THIS DISMAL STATE OF AFFAIRS BY TRYING TO CREATE AN ARAB FREE TRADING AREA OF SORTS AND EVEN ARRIVING IN DUE COURSE AT AN ARAB CUSTOMS UNION. HOWEVER, GIVEN THE VARYING POLITICAL AND ECONOMIC SYSTEMS IN ARAB COUNTRIES AND SMALL AMOUNT OF INTER-ARAB TRADE, A NAFTA- OR EU-TYPE TRADE BLOC SEEMS FARFETCHED. IN ADDITION, THE AFTA ITSELF HAS A NUMBER OF LOOPHOLES THAT NEED TO BE CLOSED, RANGING FROM RULES OF ORIGIN TO LONG LISTS OF EXEMPTED PRODUCTS EXTENSIVE TBT'S, AS WELL AS EXCLUSION OF FREE TRADE ZONES. THESE WILL GREATLY DAMPEN THE GROWTH POTENTIAL SUCH AN AGREEMENT COULD PROVIDE. THAT SAID, TO THE EXTENT THE AFTA IS IMPLEMENTED, COUNTRIES LIKE JORDAN THAT HAVE TAKEN BOLDER STEPS AT ECONOMIC LIBERALIZATION ALREADY STAND TO GAIN THE MOST -- AS THE INCREASED TRADE FIGURES OF THE LAST 18 MONTHS SUGGEST.

BERRY